

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105**

RH03030726

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INITIAL STATEMENT OF REASONS

INTRODUCTION

California Insurance Commissioner John Garamendi (Commissioner) will hold a public hearing to consider adopting sections 2399.0 through 2399.3 to Title 10, Chapter 5, Subchapter 3, Article 7.4 of the California Code of Regulations. The proposed regulations will implement, interpret and make specific the provisions of Division 2, Part 1, Chapter 8.5 of the CIC, entitled "Earthquake Insurance."

These regulations are authorized by *CalFarm v. Deukmejian* (1989) 48 Cal.3d 805, 825 [258 Cal.Rptr. 161] and *20th Century v. Garamendi* (1994) 8 Cal. 4th 216, 280 [32 Cal.Rptr.2d 807], which recognize the Commissioner's inherent authority to exercise those powers that may fairly be implied from the statutes granting his powers.

The Commissioner believes that the proposed regulations are necessary to prevent unlawful discrimination against residential property owners with property that poses a unique risk of loss due to an earthquake. These regulations will clarify the types of underwriting eligibility criteria that are prohibited by the mandatory earthquake offer statutes. The proposed regulations are reasonably necessary to remove any ambiguity regarding the purpose or effect of the mandatory earthquake insurance laws, as those laws relate to an insurer's underwriting practices.

SPECIFIC PURPOSE AND NECESSITY OF THE REGULATIONS

The specific purpose of each regulation and the rationale for the Commissioner's determination that each regulation is reasonably necessary to carry out the purpose for which it is proposed are set forth below. Implementation of these regulations is necessary for the effective enforcement of the mandatory earthquake offer statutes in the Insurance Code.

Section 2399.0 Preamble and Scope

This section describes the scope and purpose of the proposed regulations. Subdivision (a) provides that residential property insurance applicants cannot have their applications rejected for reasons that relate to the risk of loss due to earthquake. Subdivision (a) also provides that a policyholder cannot have his or her insurance policy canceled or non-renewed when such cancellation or non-renewal is based upon the subject property's risk of loss due to earthquake. Subdivision (b) identifies the types of insurance transactions that are the subject of the proposed

regulations. Subdivision (c) identifies the applicable statutory provisions that pertain to the administration, enforcement and interpretation of the proposed regulations.

This section is necessary not only because it provides clarity and ease of reference to those who are subject to the mandatory earthquake offer statutes, but also because it notifies the reader of the general scope and purpose of the proposed regulations.

Section 2399.1 Prohibited Eligibility Criteria; Presumptions and Burden of Proof

Subdivision (a) of this section provides specific, concrete examples of underwriting eligibility criteria that are prohibited by the statutory scheme, due to the fact that such criteria are related to the risk of loss due to an earthquake. Subdivision (b) flows directly from subdivision (a) by establishing a general prohibition against the use of any other eligibility guidelines, when based on elements of the subject property which are solely related to the risk of earthquake damage. Finally, because the Insurance Code recognizes that insurers must bear the burden to show that their property and casualty insurance rate filings meet the requirements of the Insurance Code, subdivision (c) of the proposed regulations recognizes that the burden remains on the insurer to show that its eligibility criteria are lawful.

This section is necessary because some insurers continue to reject, cancel or non-renew certain residential property insurance risks for reasons solely related to the subject property's risk of loss due to earthquake. Examples of the kinds of eligibility criteria that have been observed are applications which have been rejected for reasons such as: a lack of foundation bolts for the home, a lack of cripple wall reinforcement, a lack of fireplace structural reinforcement and a home's absence of a hot water heater bracing apparatus. Because it is futile to attempt to list all of the possible eligibility criteria which might be used to reject residential property insurance applicants for reasons solely due to risk of earthquake damage, the Commissioner's proposed regulations also provide a general prohibition against such eligibility criteria and remind insurers that they must bear the burden to show that any suspect eligibility guideline is necessary for reasons that are unrelated to an earthquake risk.

Section 2399.2 Earthquake Insurance Rates

Subdivision (a) of this proposed regulation recognizes the need for insurers to seek prior approval for residential property insurance and earthquake insurance rates prior to their use. Insurance Code sections 1851 and 1861.13 provide that residential property insurance and earthquake insurance are among the lines of insurance with rates subject to prior approval in California. CIC sections 12926 and 12921 identify the Commissioner's mandate: to ensure full compliance with all of the provisions of the CIC, which includes the mandatory earthquake offer provisions found in Chapter 8.5 of the CIC.

This section is necessary because it provides clarity, and references the statutes that the proposed regulations concern. It notifies those entities that are subject to the Commissioner's regulatory authority that, like other types of insurance rates, residential property and earthquake insurance rates filed in California must not be excessive, inadequate, or unfairly discriminatory. The

regulation further provides that insurance rates also must not violate the provisions of the mandatory earthquake offer, which are found in Chapter 8.5, beginning with CIC section 10081.

Section 2399.3 Severability

This regulatory provision expresses the Commissioner's intent that the proposed regulations be given full effect. To the extent that any provision of the proposed regulations were to be invalidated by a court or the Legislature, this proposed regulation ensures that the remaining valid provisions are preserved. This provision is necessary because it expressly recognizes the Commissioner's intention to apply these regulations to the fullest extent permitted by the law.

IDENTIFICATION OF STUDIES

There are no specific studies relied upon in the adoption of this article.

SPECIFIC ACTIONS, PROCEDURES, TECHNOLOGIES OR EQUIPMENT

Adoption of these regulations would not mandate the use of specific technologies or equipment.

REASONABLE ALTERNATIVES

The Commissioner has determined that no reasonable alternatives exist to carry out the purpose for which the regulations are proposed. Performance standards were considered but were rejected as an unreasonable and impracticable alternative. Nevertheless, the Commissioner invites public comments on the proposed changes and reasonable alternatives which would be as effective to carry out the proposed changes.

ECONOMIC IMPACT ON SMALL BUSINESS

Because the matters proposed herein will affect insurance companies, the proposed regulations will not affect small business. (See Gov. Code § 11342.610, subd. (b), para. (2).)

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

The Commissioner does not foresee that the proposed regulations will have an adverse economic impact on small business. The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business.